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Supreme Court of the United States

October Term, 1977

Nos. 77-10, 77-11, 77-12,
77-47, and 77-64

EXXON CORPORATION and PHILLIPS PETROLEUM COMPANY, SHELL OIL COMPANY, CONTINENTAL OIL COMPANY and KAYO OIL COMPANY, GULF OIL CORPORATION, ASHLAND OIL, INC., COMMONWEALTH OIL REFINING COMPANY, INC. and PETROLEUM MARKETING CORPORATION,

Appellants,

v.

GOVERNOR OF THE STATE OF MARYLAND, *et al.*,

Appellees.

ON APPEAL FROM THE
COURT OF APPEALS OF MARYLAND

BRIEF OF APPELLANTS ASHLAND OIL, INC., COMMONWEALTH OIL REFINING COMPANY, INC., and PETROLEUM MARKETING CORPORATION

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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-64

ASHLAND OIL, INC., COMMONWEALTH OIL REFINING COMPANY, INC. and PETROLEUM MARKETING CORPORATION,
Appellants,

v.

GOVERNOR OF THE STATE OF MARYLAND, *et al.*,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

BRIEF OF APPELLANTS ASHLAND OIL, INC., COMMONWEALTH OIL REFINING COMPANY, INC. AND PETROLEUM MARKETING CORPORATION

This brief is submitted by Ashland Oil, Inc. ("Ashland") and by Commonwealth Oil Refining Company, Inc. ("Commonwealth") and its subsidiary Petroleum Marketing Corporation ("PMC") in support of their appeals from that portion of the judgment of the Court of Appeals of Maryland, entered on February 18, 1977, which denied their claim that Paragraphs B and C of the Maryland Fuel Inspection Law, as amended (the "Maryland Act"), are invalid under Article I, Section 8, of the United States Constitution (the "Commerce Clause").

Other appellants in this consolidated appeal have also challenged Paragraph D of the Maryland Act.[1] Ashland and Commonwealth-PMC have not appealed the decision below as it relates to Paragraph D because their operations in Maryland would not be affected if this section of the Maryland Act were upheld. However, Ashland and Commonwealth-PMC support all arguments advanced by all the appellants. This separate brief has been filed solely because Ashland and Commonwealth-PMC believe their status as independent refiner-marketers operating in Maryland requires a separate statement of position.

OPINIONS BELOW

The main opinion of the Court of Appeals of Maryland is reported at 279 Md. 410, 370 A.2d 1102. A supplemental opinion, denying motions for reconsideration and for a stay of judgment, is reported at 279 Md. 456, 372 A.2d 237. The trial court rendered two opinions, neither of which is officially reported. The four opinions are reproduced in the Joint Appendix to Jurisdicitonal Statements.

JURISDICTION

The federal question presented here was raised in appellants' bills of complaint, filed in the Circuit Court for Anne Arundel County. (A. 136).[2] That court held the Maryland Act unconstitutional on a number of grounds, but ruled that it did not violate the Commerce Clause. (J.A. 123a).[3] On appeal, appellants renewed their Commerce

[1]Exxon Corporation, Phillips Petroleum Company, Shell Oil Company, and Gulf Oil Corporation have filed a brief challenging Paragraphs B, C and D of the Act. Continental Oil Company and its subsidiary Kayo Oil Company have limited their appeal to Paragraph C.

[2]"A." denotes the Appendix filed jointly by all parties to this consolidated appeal.

[3]"J.A." denotes the Joint Appendix to Jurisdictional Statements.

Clause arguments. The Court of Appeals of Maryland reversed the Circuit Court, holding that the Act was constitutional in all respects. In doing so, it specifically rejected appellants' Commerce Clause contentions. (J.A. 16a-24a).

The opinion of the Court of Appeals, which constitutes its judgment, was entered on February 18, 1977. Motions for reconsideration and for a stay of mandate were timely filed but were denied in a supplementary opinion filed on April 13, 1977. (J.A. 45a).

Notices of appeal to this Court were filed by Ashland on July 1, 1977 (J.A. 151a), and by Commonwealth and PMC on July 11, 1977.[4] The jurisdiction of this Court is invoked under 28 U.S.C. §1257(2). Probable jurisdiction was noted on October 3, 1977.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Constitutional Provisions

Article I, Section 8, Clause 3, of the United States Constitution provides that

> The Congress shall have Power . . . To regulate Commerce with Foreign Nations and among the several States, and with the Indian Tribes.

Statutes

Chapter 854, Laws of Maryland 1974, as amended by Chapter 608, Laws of Maryland 1975, added the following provisions to the Motor Fuel Inspection Law:

[4]The Commonwealth and PMC notices of appeal are reproduced as an appendix to the Jurisdictional Statement filed in No. 77-64.

(B) After July 1, 1974, no producer or refiner of petroleum products shall open a major brand, secondary brand or unbranded retail service station in the State of Maryland, and operate it with company personnel, a subsidiary company, commissioned agent, *or under a contract with any person, firm, or corporation, managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.*

(C) After July 1, 1975, no producer or refiner of petroleum products shall operate a major brand, secondary brand, or unbranded retail service station in the State of Maryland, with company personnel, a subsidiary company, commissioned agent, *or under a contract with any person, firm, or corporation managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.*

(D) Every producer, refiner, or wholesaler of petroleum products supplying gasoline and special fuels to retail service station dealers shall extend all voluntary allowances uniformly to all retail service station dealers supplied.

(E) Every producer, refiner, or wholesaler of petroleum products supplying gasoline and special fuels to retail service station dealers shall apply all equipment rentals uniformly to all retail service station dealers supplied.

(F) Every producer, refiner or wholesaler of petroleum products shall apportion uniformly all gasoline and special fuels to all retail service station dealers during periods of shortages on an

equitable basis, and shall not discriminate among the dealers in their allotments.

(G) The Comptroller may adopt rules or regulations defining the circumstances in which a producer or refiner temporarily may operate a previously dealer-operated station.

(H) The Comptroller may permit reasonable exceptions to the divestiture dates specified by this section after considering all of the relevant facts and reaching reasonable conclusions based upon those facts.

The italicized portions were added by Chapter 608, Laws of Maryland 1975. The quoted provisions now appear as Article 56, Section 157E(b)-(h), Annotated Code of Maryland (1972 Repl. Vol., 1976 Cum. Supp., pp. 42-43). They are referred to hereafter as the "Maryland Act" or the "Act."

QUESTION PRESENTED

Whether Paragraphs (B) and (C) of the Maryland Act, which would prevent independent refiner-marketers such as Ashland and Commonwealth-PMC from operating private brand, discount gasoline stations in competition with major brand dealers, constitute an undue burden on and an unlawful discrimination against interstate commerce in violation of the Commerce Clause.

STATEMENT OF THE CASE

The legislation here at issue had its inception in 1973 and 1974 during the gasoline shortage which occurred following the crude oil embargo imposed by the Organization of Petroleum Exporting Countries ("OPEC"). The initial question was whether the shortage was "real or contrived," and whether

suppliers were fairly allocating available gasoline among different classes of retailers.[5] The ultimate legislative response, however, was an ambitious plan to restructure the retail gasoline market within the State of Maryland.

Paragraphs B and C of the Maryland Act prohibit producers and refiners[6] of petroleum products from operating retail service stations with company personnel, and provide that all such stations "must be operated by a retail service station dealer." These provisions apply to all stations, whether "major brand," "secondary brand," or "unbranded," and to all refiners. However, the effects of the prohibition will not be distributed evenly among all retail stations or among all refiners. Some retail outlets are operated primarily by dealers; others are operated exclusively by salaried personnel. One type of refiner supplies the dealer-operated stations; another type supplies the company-operated stations.

Although the categories overlap, the basic division at the retail level is between "major brand" and "private brand" stations. The basic division at the refining level is between "major oil companies" and "independent refiner-marketers." A brief explanation of these differences is necessary to a full understanding of this case.[7]

[5]The legislative history is outlined in the opinion of the Maryland Court of Appeals (J.A. 7a-10a), and is more fully discussed at pp. 32-34, *infra*.

[6]All the producing companies that operate retail service stations in Maryland are also refiners. For convenience, the term "refiners" will be used to include both crude oil "producers" and petroleum product "refiners."

[7]None of the evidentiary facts is in dispute. The basic facts were stipulated prior to trial. (A. 178-302). Additional facts were supplied by company and expert witnesses who testified at the trial. The State made no effort to controvert the facts established by these witnesses. The only evidence it offered consisted of documents and testimony relating to the Act's legislative history, and the opinion of one expert respecting its economic effects.

A. The Retail Gasoline Market

In Maryland, as elsewhere, the most common form of retail gasoline establishment is the "major brand" service station. These stations sell nationally advertised brand-name products, accept credit cards issued by the major brand supplier, and usually offer a full line of ancillary services, such as minor road repairs and tire and battery sales. (A. 306, 350-51, 368, 559-60).

A less common form of retailing is the "private brand" station. These stations sell only gasoline and motor oil; they use a multitude of unadvertised trade names, offer few, if any, services and do not accept credit cards. Such stations are sometimes referred to as "gas-and-go" outlets to distinguish them from major brand "service" stations. Private brand stations attract customers by offering gasoline at prices significantly lower than those posted by the major brand stations. (A. 349, 371, 517, 527-28). In areas where both types of stations are present, the consumer has a choice; he may patronize a major brand station, to obtain greater service, or a private brand station, to obtain a lower price.

The vast majority of major brand stations are operated by independent dealers under agreements with the oil companies that supply them.[8] Private brand stations are rarely operated by dealers, but instead are operated by salaried employees of the companies that own the stations. (A. 529, 628). The private brand operators who testified at the trial stated that none of their stations in Maryland or elsewhere were operated by dealers. (A. 348, 450, 460-61, 517).

[8]For example, as of July 1, 1974, Maryland had 628 Exxon stations, 219 Gulf stations, 128 Phillips stations, and 284 Shell stations, of which only 32 Exxon, 1 Gulf, 10 Phillips, and 1 Shell station were company-operated. Other major oil companies operating in the State, such as Texaco (307 stations), Union Oil (152 stations), and Sun Oil Company (225 stations), used independent dealers exclusively. (A. 190-91).

The reason for this is found in the economics of a successful private brand operation. To sell gasoline at a lower price, private brand operators must maintain high volume and low overhead. (A. 356, 452, 457-58, 528-29). These objectives are achieved by small investment in the property, no advertising, no service facilities, no credit, long hours of operation, few employees, and skeletal administrative forces. (A. 348-56, 453-54, 506-07). The private brand operators' high-volume, low-margin strategy works only if there is strict control of pricing and hours of operation, which cannot be achieved, legally or practically, if the station is controlled by an independent dealer. (A. 357, 450, 455, 503-04, 508, 517, 628).

Private brand stations are operated by several different kinds of companies. Some are mass merchandisers, such as discount and department stores and food chains. (A. 509). Others are wholesale jobbers, which distribute to retailers and also operate retail stations of their own. (A. 569). Still others are independent marketers, which sell only at retail and have no wholesale operations. (A. 604). However, the largest number of private brand stations in Maryland are operated by refiners.[9]

[9]As of July 1, 1974, there were 233 company-operated stations in Maryland. Of these 233 stations, 36 were private brand stations operated by nine companies having no association with a refiner (Fisca Oil Co., Giant Food, Hi-Way Oil, Inc., Homes Oil Co., Hudson Oil Company, Midway Petroleum, Pantry Pride, Savon Gas Stations, and Sears, Roebuck and Co.). The remaining 197 were operated by refiners. Approximately 55 of these 197 refiner-operated stations were major brand stations; the remaining 142 were refiner-operated private brand or secondary brand stations. (A. 190-91, 370). Some of these private and secondary brand stations are associated with major oil companies — *e.g.*, Alert (Exxon), Way-Lo (Phillips), Kayo (Continental), and BP Gas & Go (British Petroleum). (A. 606-07). Most, however, are associated with independent refiner-marketers — *e.g.*, Ashland, Commonwealth-PMC, Amerada Hess/Meadville, and Crown. (A. 376, 386).

The total number of private brand stations in the State is small — there are fewer than 200 such stations.[10] However, they are nonetheless significant factors in the market because of their low prices and high volumes. The typical private brand gas-and-go outlet sells approximately 180,000 to 200,000 gallons of gasoline a month; the typical dealer-operated station has a much lower volume. (A. 464, 530). Although separate figures for the retail market are not available, companies identified as private brand operators accounted for 24.8 per cent of all taxable gasoline sales in 1975. (A. 191-92, 409, 416).

B. Suppliers to the Retail Market

Maryland has no crude oil production fields, and no refineries operate within its borders. (A. 571, J.A. 19a). All motor vehicle fuels sold in Maryland are produced and refined elsewhere and transported into the State by pipeline, ship, or truck. (A. 194, 212-13, 216-17, 224-25, 256, 257-58, 455).

The out-of-state companies that supply gasoline to the Maryland market are of two basic types. The most significant group is comprised of "major oil companies." Major oil companies are fully integrated companies engaged in the production, refining, transportation and marketing of petroleum products. These companies own or control a substantial proportion of the crude oil used in their refineries, and sell most of their refined products through independent dealers operating major brand retail service stations. (A. 498, 526). Fifteen major oil companies do business in the United States; all fifteen operate in Maryland. (A. 376).

The Maryland market is also supplied by a number of "independent refiner-marketers." These are partially integrated companies that do not control a significant por-

[10]See note 9, *supra*.

tion of their crude oil supplies and sell most of their refined products at wholesale to independent purchasers. (A. 498, 526-27).[11] These independent refiners represent the principal sources of supply for the mass merchandisers, wholesalers and independent marketers that operate private brand stations. (A. 498, 509, 623-24). Of the 37 largest companies classified nationally as "independent refiners," only five do business in Maryland. (A. 376).

Although major oil companies can and do operate some private brand stations,[12] they have traditionally chosen to market most of their products through dealer-operated major brand service stations. Independent refiners, on the other hand, have not found it possible to market through dealers but instead have relied on company-operated

[11]This generally accepted industry definition has been incorporated into the Energy Petroleum Allocation Act of 1973, 15 U.S.C. §753:

> The term "independent refiner" means a refiner who (a) obtained, directly or indirectly, in the calendar quarter which ended immediately prior to the date of enactment of this Act, more than 70 per centum of his refinery input of domestic crude oil (or 70 per centum of his refinery input of domestic and imported crude oil) from producers who do not control, are not controlled by, and are not under common control with, such refiner, and (b) marketed or distributed in such quarter and continues to market or distribute a substantial volume of gasoline refined by him through branded independent marketers or nonbranded independent marketers.

[12]Two of the major oil companies in this case, Exxon Corporation and Phillips Petroleum Company, sell primarily through dealer-operated branded outlets, but also operate "secondary brand" stations under the "Alert" and "Way-Lo" trade names. (A. 195-96, 235). Continental Oil Company, a major oil company, does not sell any "Conoco" brand gasoline in Maryland. Its wholly-owned subsidiary, Kayo Oil Company, sells at retail in Maryland and elsewhere through company-operated private brand "Kayo" outlets. (A. 212-13). The Kayo, Alert and Way-Lo stations are operated with company personnel, and employ a "gas and go" format similar to that used by the private brand stations. (A. 232, 236-37, 311).

private brand gas-and-go outlets to sell a portion of their production. To understand why this is so, one must understand the position of independent refiners in the national petroleum industry.

Historically, independent refiners have competed successfully with the majors. To do so, however, they have been required to adapt their operations to two problems characteristic of their position in the industry.

First, refining is capital-intensive and thus is not efficient unless plant capacities are fully utilized. (A. 501, 531). Since independent refiners do not control an assured source of crude oil, they are subject to periodic supply interruptions. When this occurs, production declines and per unit costs increase. (A. 501-03).

Second, lack of a controlled crude supply makes independent refiners vulnerable to fluctuations in the costs of raw materials. The independents must buy their crude oil from uncontrolled sources at prevailing market prices and sell their refined products in the wholesale market to customers they do not control. Increases in crude prices rapidly affect the independents' market position by driving their wholesale prices above the prices posted by competitors having access to controlled sources of lower cost supply. When this happens the independents must either absorb the added crude costs, with lessened profitability, or attempt to recover the increased costs from their customers and risk the loss of wholesale business. (A. 503-05).[13]

[13]These characteristics caused extreme difficulties for independent refiners during the fuels crisis of 1973-74, when crude shortages and escalating world crude prices placed independents at a severe competitive disadvantage. The result was an inability to supply wholesale customers at competitive prices. In Ashland's case, this produced a sudden loss of wholesale customers, who defected to other suppliers. (A. 504-05, 514). If Ashland had not been able to continue marketing

(continued)

The response of independent refiners to these problems has been to seek assured outlets for their products in order to maintain continuous production volume. (A. 505, 527). The major oil companies achieve the same objective by establishing a network of retail dealers, who typically lease their stations from the major oil company and purchase its refined products for resale at branded outlets. (A. 526). A system of this sort is not feasible for independent refiners because it can work only if the dealers can offer a recognized brand of gasoline; independent refiners simply do not have the financial resources to develop the brand recognition which this form of retail marketing requires. (A. 502-03, 527-28). Consequently, the independents have come increasingly to rely on company-operated stations which sell unbranded gasoline at discount prices, because this is the only practical way for them to enter distant markets and compete in those markets with the major oil companies. (A. 528-29).

[13](continued)

gasoline through its own retail outlets, it would have been obliged to reduce refinery runs which in turn would have further impaired the profitability of its business. (A. 504-05). Commonwealth experienced similar, and indeed more severe, difficulties during the same period. (A. 445-47). The federal government responded to the fuels crisis by enacting the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§751-757, which provides for allocation of energy supplies to compensate for crude cost disadvantages suffered by independents. (A. 291-94; *see generally* A. 262-300). Sections 4(b)(2)(D) and (F) of the act reflect an express Congressional recognition that the program mandated by the Act was designed in part "to preserve the competitive viability of independent refiners, [and] small refiners" during the period of shortages and crude cost dislocations. (*See also* A. 533, 624-25).

C. Ashland, Commonwealth and PMC

Ashland and Commonwealth are independent refiners.[14] Ashland operates seven refineries located in Kentucky, Pennsylvania, New York, Ohio and Michigan. (A. 144). Commonwealth operates a single refinery in Penuelas, Puerto Rico. (A. 255, 449). PMC is Commonwealth's marketing subsidiary. (A. 256).

Ashland and PMC sell gasoline in Maryland, both at wholesale and at retail. (A. 509-10, 623-24). The gasoline that PMC sells in Maryland is refined in Commonwealth's Puerto Rico refinery, shipped by tanker to Baltimore, and then distributed to customers and retail outlets by company-leased trucks or by common carrier. (A. 455). The gasoline that Ashland sells in Maryland is not produced by its own refineries, because no waterway or pipeline connection links them with the State. Instead, Ashland exchanges products with other refiners which do have transportation access to the market. Ashland's current exchange partner is Continental Oil Company, which transports gasoline produced at Gulf Coast refineries into Maryland via the Colonial Pipe Line. (A. 509, 212).

Ashland sells at retail in Maryland through seventeen gasoline-only outlets operating under the "Red Head," "Bi-Lo," "Payless" and "Hi-Fi" trade names. (A. 258). These stations represent a total investment of about $2.4 million; in 1974, they sold almost 27 million gallons of

[14]Ashland purchases about 85% of its crude oil requirements from domestic or foreign petroleum producers over which it has no control. (A. 257, 497-98). Commonwealth purchases 100% of its crude requirements from other producers. (A. 255). Approximately 60% of Ashland's refinery production is sold at wholesale to independent accounts; approximately 8% is sold to Ashland branded dealers in a small area adjacent to its main refinery at Ashland, Kentucky; the remaining 32% is sold through company-operated outlets located in the Midwestern, Atlantic Coast and Southeastern states. (A. 502-04). Commonwealth's sales reflect a similar pattern. (A. 256, 463).

gasoline. (A. 259). PMC's retail sales are conducted under the "Scot" trade name. There are 21 Scot stations in Maryland.[15] (A. 449). PMC's total investment in these stations is about $2 million (A. 655); the average Scot station sells about 190,000 gallons of gasoline per month. (A. 464).

The Ashland and PMC stations follow the standard marketing format used by private brand marketers. They sell gasoline and motor oil only, accept only cash, and offer no services. The stations are open 18 hours a day, 365 days a year. They usually sell at one to three cents per gallon below the prices of nearby major brand stations. (A. 451-52, 492). All stations are operated by salaried company employees; none has ever been operated by a dealer. (A. 257-58, 489). Ashland and Commonwealth operate company-owned private brand stations in Maryland because it is the only feasible way for them to function in this market. (A. 502-04, 508, 626).

Both companies also sell gasoline at wholesale; Ashland is a principal source of wholesale supply for the independent marketers that operate private brand stations in the State. (A. 509, 624). As elsewhere, Ashland uses its retail outlets to balance wholesale sales, which fluctuate in volume as wholesale prices change. (A. 509-10). This balance must be maintained because Ashland can supply its Maryland customers only by means of exchange agreements with other oil companies that deliver gasiline directly into the State; such agreements cannot be maintained unless both parties can exchange products on a regular basis. *(Id.)*.

[15]Subsequent to the filing of its Jurisdictional Statement, PMC agreed to sell all of its Maryland retail stations to another company. However, PMC hopes to continue selling gasoline at wholesale in the State if conditions permit.

D. Effects of the Maryland Act

The prohibition against refiner operation of retail service stations will have little effect on the major brand stations, the vast majority of which are operated by dealers. The principal impact of the statute will fall on private brand stations, virtually all of which are operated with company personnel.

The requirement that refiners can distribute their products only at wholesale or through dealers will impose a burden on all refiners now selling in the State at retail through company-operated outlets. The burden will fall most heavily on Ashland, Commonwealth and other refiners which operate only private brand stations and have no dealers. They cannot convert their stations to dealers, because private brand gas-and-go outlets simply cannot be operated profitably by dealers. Their only practical alternative would be to sell the stations and withdraw from retail operations in the State. (A. 357-58, 457, 508, 531). Some stations might be sold to eligible non-refiner marketers for continued use as private brand outlets — if buyers could be found. However, many would undoubtedly be permanently closed. (A. 533-34).

All witnesses who testified at the trial — including the State's expert — agreed that the private brand segment of the market provides significant competition to the major brand stations offering gasoline at discount prices. (A. 356, 370-71, [illegible] 7, 452. 517, 588-89). Thus, the immediate and most direct effect of the Act would be to eliminate most of the private brand stations from the State, which would reduce competition and increase prices. (A. 501-05, 531-32).

This, however, would not be the only adverse consequence if the Act is sustained. The Act would injure the remaining private brand operators in the market by

reducing available supplies and by preventing them from expanding their operations into refining. The Act would also injure the entire market by erecting barriers which would discourage any new refiner from entering the State.

The principal sources of supply for private brand operators have traditionally been the independent refiners. (A. 509, 623-24). If these refiners lose their retail outlets in the State, they will also lose incentive to continue to supply the wholesale market. Both Ashland and Commonwealth testified they would find it extremely difficult to continue wholesale operations if they could not also operate at retail. (A. 462-64, 509). The most likely effect of loss of the retail outlets would be a decision to divert this gasoline to other states where it could be profitably sold. (A. 508). No evidence was offered to show that other wholesaler suppliers would come forward to supply the private brand market if Ashland and Commonwealth withdraw.

Successful independent marketers eventually find they can no longer depend exclusively on wholesale purchases for their needs. The historical pattern has been one of growth at the retail level followed by "backward integration" into refining. (A. 378-80, 427-29). For example, PMC was originally an independent marketer which merged into Commonwealth as it grew and its supply needs increased. (A. 462). Hudson Oil Company, which is one of the largest independent marketers operating in Maryland, has announced plans to build its own refinery in order to improve operations. (A. 518-19). If the Act is sustained, Hudson will have to abandon its expansion plans or withdraw from the State. Hudson's owner testified that, if this choice were forced upon her, she would withdraw. (*Id.*).[16]

The Act would also harm the entire market by erecting barriers which would discourage any new competitors from

[16]Subsequent to the trial, Hudson did acquire a refinery. Oil & Gas Journal, *Annual Refinery Issue* (March 28, 1977), p. 117.

entering the State. In a free market, the most likely potential entrants would be independent refiners operating retail outlets on a national or regional basis. However, these refiners do not have the economic resources to enter as branded operators using dealers, and thus would be excluded if they could not operate their own private brand outlets. (A. 377).[17] The larger independent marketers would also be discouraged from entering, both because of supply problems and because entry would deprive them of the option of further growth by means of backward integration into refining. Even major oil companies would find it difficult to enter the State as branded operators, because the usual entry method involves establishing an initial group of company-operated stations until the stations can be converted to dealer operations.[18]

The overall result of the Maryland Act will be to reduce competition and increase prices. The principal losers will be private brand operators and consumers. The only clear winners will be the major brand dealers, who will be shielded from the competition of private brand operators. Whether Maryland may legitimately restrict its market to protect this class of local merchants is a principal issue before this Court.

[17]Ashland's experience in this regard is instructive. It has in past years attempted to enter the Pennsylvania, Ohio and Michigan markets as a branded operator. These efforts failed after substantial losses forced it to withdraw from these areas. (A. 501-03). It is Ashland's judgment, supported both by experience and by expert opinion, that it could not market gasoline beyond its home territory except through company-operated outlets. (A. 503-04, 528).

[18]In 1962, Exxon Corporation entered the Florida market in this way. Despite Exxon's size and vast financial resources, more than 5 years of promotional efforts were required before its brand name was sufficiently well established to permit a shift to dealers. (A. 317-18).

SUMMARY OF ARGUMENT

Although the states retain a residuum of power to adopt laws which affect interstate commerce, this power may not be used to interfere with natural functioning of the interstate market. State laws which have the practical effect of burdening interstate commerce by increasing operating costs and reducing the competitive strength of interstate businesses transgress this principle. So, to, do state laws which discriminate against interstate commerce in favor of local interests.

There can be no doubt that the legislation here at issue affects interstate commerce. All gasoline sold in Maryland is produced and refined elsewhere and transported into the State by ship, truck or common carrier pipeline. This gasoline is sold not only to local consumers but also to interstate travellers and trucking companies engaged in interstate commerce. The Maryland Court's conclusion that the Act regulated a "wholly intrastate activity" (J.A. 18a) is patently erroneous.

Nor can there be any doubt that the Maryland Act imposes a substantial burden on interstate commerce. Paragraphs B and C of the Maryland Act prohibit refiners from operating retail service stations with company personnel. Its principal impact will fall on those refiner-marketers, such as Ashland and Commonwealth, that sell low-cost private brand gasoline at retail exclusively through company-operated outlets. Companies of this type cannot operate in Maryland through branded dealers, and thus would be obliged to withdraw from the retail market if the Act is sustained. Loss of their retail outlets would also make it extremely difficult for the independent refiner-marketers to continue wholesale operations in the State. The result will be a diversion of gasoline to other areas, which will harm the remaining private brand operators in the market who depend upon the independent refiners for supplies.

The prohibition against company operation of retail service stations would also discourage all classes of marketers from entering the State. The overall effect of the Act, therefore, will be to reduce competition and increase prices. These effects, which interfere with the free flow of interstate goods, are plainly substantial.

It is also clear that the burdens imposed by the Act have the effect of discriminating against interstate commerce. All of the refiners that sell gasoline at retail in Maryland through company-operated stations are out-of-state businesses which transport gasoline into the State for that purpose. Most of these company-operated retail outlets sell private brand gasoline at discount prices in direct competition with dealer-operated major brand service stations. The general effect of the Act will be to shield the local dealers who operate major brand service stations from competition with the out-of-state refiners that operate private brand stations.

Although the Maryland Court found the Act facially neutral (J.A. 19a-20a), the legislative history shows that it was adopted in response to pressures from local dealers and was amended so that it would apply only to out-of-state refiners. This history, considered in relation to the Act's disproportionate impact on the refiner-marketers that compete with the local dealers, conclusively demonstrates a discrimination against interstate commerce.

When a state regulation comes into conflict with the Commerce Clause, this Court weighs the competing state and federal claims in an effort to accommodate the state's interest with the overriding requirement of freedom of commerce. If discrimination against interstate commerce is involved, the state has the burden of justifying the discrimination both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives.

The discriminatory burdens imposed by the Maryland Act on independent refiner-marketers cannot be justified. The Act was ostensibly designed to protect retail service station dealers from alleged discriminations in supply between company-operated and dealer-operated stations, and to prevent suppliers from converting dealer-operated stations to company operations. These purported justifications for the Act have no application to independent refiner-marketers, such as Ashland and Commonwealth, that operate at retail exclusively through company-owned outlets and have no dealers. The only consequence of the Act, as applied to companies like Ashland and Commonwealth, would be to eliminate an important source of price competition in the marketplace. This would not promote competition, as the State contended, but would rather weaken it to the consumer's detriment.

The very purpose of the Commerce Clause was to create an area of free trade among the several states. The unjustified exclusion of independent refiner-marketers such as Ashland and Commonwealth from the Maryland retail market flies in the face of that fundamental constitutional principle.

ARGUMENT

PARAGRAPHS B AND C OF THE MARYLAND ACT CONSTITUTE AN UNDUE BURDEN ON AND AN UNLAWFUL DISCRIMINATION AGAINST INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE.

Article I, Section 8, Clause 3 of the Constitution grants Congress the power "to regulate Commerce . . . among the

several States . . . ." Although the primary authority to regulate interstate commerce rests with Congress, this Court has long

> recognized that, in the absence of conflicting legislation by Congress, there is a residuum of powers in the state to make laws governing matters of local concern which nevertheless in some measure affect interstate commerce or even, to some extent, regulate it.

Southern Pacific Co. v. Arizona, 325 U.S. 761, 767 (1945).

This residuum of state power, however, is subject to the requirement that the regulation not interfere with the principle, "well established by the history of the Commerce Clause, that this Nation is a common market in which state lines cannot be made barriers to the free flow of both raw materials and finished goods in response to the economic laws of supply and demand." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 803 (1976). As this Court recently observed, "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328 (1977); *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366, 370 (1976). That purpose cannot be frustrated by state legislation which "comes into conflict with the Commerce Clause's overriding requirement of a national 'common market'." *Hunt v. Washington State Apple Advertising Commission*, ____ U.S. ____, 97 S.Ct. 2434, 2445 (1977).

Defining the limit of the states' power to regulate companies engaged in interstate commerce "has been the continuing task of this Court." *Boston Stock Exchange v. State Tax Commission, supra*, 429 U.S. at 329. This task involves a "'delicate adjustment of the conflicting state and federal claims'" to achieve "the necessary accommodation between local needs and the overriding requirement of free-

dom for national commerce." *Great Atlantic & Pacific Tea Co. v. Cottrell, supra,* 424 U.S. at 371. The final arbiter in all such determinations, of course, is this Court, not the state legislatures. *Breard v. Alexandria,* 341 U.S. 622, 648 (1951); *Southern Pacific Co. v. Arizona, supra,* 325 U.S. at 769.

Although resolution of particular conflicts between competing state and federal interests necessarily turns on the circumstances of individual cases, certain basic principles have guided this Court's determinations. It is thus well established that a state may not burden commerce by regulations which have the practical effect of increasing operating costs, hampering efficiency, or otherwise reducing the competitive strength of interstate businesses. *Hunt v. Washington State Apple Advertising Commission, supra,* 97 S.Ct. at 2445; *Great Atlantic & Pacific Tea Co. v. Cottrell, supra,* 424 U.S. at 373-75; *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 143-46 (1970); *H.P. Hood & Sons v. Du Mond,* 336 U.S. 525, 539 (1949); *Southern Pacific Co. v. Arizona, supra,* 325 U.S. at 781-82. So, too, is it clear that a state may not discriminate against interstate commerce by regulations that favor local interests over interstate competitors. *Hunt v. Washington State Apple Advertising Commission, supra; H.P. Hood & Sons v. Du Mond, supra; Dean Milk Co. v. City of Madison,* 340 U.S. 349 (1951); *Nippert v. City of Richmond,* 327 U.S. 416 (1946); *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511 (1935); *Buck v. Kuykendall,* 267 U.S. 307 (1925).

If a state regulation burdens interstate commerce, but does not discriminate against it, this Court seeks to accommodate the competing federal and state interests by balancing the relative strengths of each:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Pike v. Bruce Church, Inc., supra, 397 U.S. at 142 (citations omitted). If the regulation also discriminates against interstate commerce, far more is required to justify it. Certain forms of discrimination are virtually illegal *per se,* no matter how legitimate the local interest served. *Id.* at 145. More subtle discriminations can sometimes be justified, but the balance favors free trade and "the burden falls on the State to justify [the discrimination] both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives, adequate to preserve the local interests at stake." *Hunt v. Washington State Apple Advertising Commission, supra,* 97 S.Ct. at 2446.

Paragraphs B and C of the Maryland Act meet none of these criteria. The prohibition against refiner-operated retail service stations burdens interstate commerce by imposing requirements which will substantially increase the costs and hamper the efficiency of all refiners that market gasoline in the State by this method. These burdens are so great in the case of Ashland, Commonwealth and other refiners selling gasoline in the private brand sector as to exclude them entirely from the market. The purpose and practical effect of the Act is to discriminate against independent refiner-marketers and other private brand operators, to the benefit of local dealers who operate major brand service stations. There is no state interest which could possibly justify this oppressive and discriminatory result.

A. The Maryland Act Imposes a Significant Burden on Interstate Commerce.

The Court of Appeals held that the Maryland Act does not violate the Commerce Clause because it "merely regulates a wholly intrastate activity, the retail marketing of gasoline." (J.A. 18a). It stated that the Act would not in any event burden interstate commerce "to a significant degree" because its implementation "would not in any way restrict the free flow of petroleum products into or out of the state." (J.A. 23a, 18a). It thus concluded that "the state's interest, as determined by the Legislature, outweighs any slight burden which the Act may impose on interstate commerce." (J.A. 24a).

The Maryland Court's first proposition reflects a serious misunderstanding of this Court's precedents. The idea that a particular activity may be exempted from the scope of the Commerce Clause simply by asserting that it is "local" in nature has long been repudiated. As Mr. Justice Rutledge stated in *Nippert v. City of Richmond, supra,* 327 U.S. at 423:

> All interstate commerce takes place within the confines of the States and necessarily involves "incidents" occurring within each State through which it passes or with which it is connected in fact. And there is no known limit to the human mind's capacity to carve out from what is an entire or integral economic process particular phases or incidents, label them as "separate and distinct" or "local," and thus achieve its desired result.

Thus, the question is not whether gasoline retailing, considered in isolation, might be characterized as a local or intrastate activity; the question is whether the Act has "substantial economic effects" on "'the transportation or intercourse which is' the commerce." *Id.*

To suggest, as did the Maryland Court, that gasoline retailing is a distinctly local activity is to ignore reality. All the motor vehicle fuels sold in Maryland are produced and refined in other parts of the country and transported into the State by ships, trucks and common carrier pipelines. These products are sold not only to local consumers, but also to interstate travellers and to trucking companies engaged in interstate commerce. (A. 196, 228-29). Retail activities having significantly fewer contacts with the flow of interstate commerce have been held within the scope of the Commerce Clause. *Daniel v. Paul,* 395 U.S. 298 (1969); *Katzenbach v. McClung,* 379 U.S. 294 (1964); *Heart of Atlanta Motel, Inc. v. United States,* 379 U.S. 241 (1964). In particular, this Court has held that companies which regularly distribute out-of-state gasoline to local retailers and wholesalers are engaged in interstate commerce within the meaning of the antitrust laws. *Standard Oil Company v. F.T.C.,* 340 U.S. 231, 236-38 (1951). It is thus too late to suggest that the direct sale of gasoline to interstate travellers and others by refiners operating across state lines does not implicate interstate commerce.

Equally erroneous is the Maryland Court's assumption that the Act would not burden commerce unless it hindered "either the import or export of goods." (J.A. 18a). This Court has not hesitated to strike down state regulations which in effect prohibited imports or embargoed exports, *see, e.g., Baldwin v. G.A.F. Seelig, Inc., supra; H.P. Hood & Sons v. Du Mond, supra,* but it has also made clear that interstate commerce may be burdened in more subtle ways. *Hunt v. Washington State Apple Advertising Commission, supra; Great Atlantic & Pacific Tea Co. v. Cottrell, supra; Pike v. Bruce Church, Inc., supra.* The "common thread" of these and many other precedents is that a state may not "interfere with the natural functioning of the

interstate market either through prohibition *or through burdensome regulation.*" *Hughes v. Alexandria Scrap Corp., supra,* 426 U.S. at 806 (emphasis added). In these cases, the question was not whether the total volume of goods transported into or out of the state would be reduced, but rather whether the regulation interfered with the interstate market by burdening individual participants in that market.

The Maryland Act requires all refiners which operate retail service stations to convert those stations to dealer operations or to abandon them. This requirement burdens all refiners by depriving them of the opportunity to engage in the direct retail sale of gasoline and to obtain the commercial benefits of that activity. This burden will be substantial for all, but it will be intolerable for Ashland, Commonwealth and the other refiners that operate private brand stations in the State. For them, the statutory requirement that refiner-owned retail stations "must be operated by a retail service station dealer" is not merely an "incidental" effect of an "even-handed" regulation, *Pike v. Bruce Church, Inc., supra,* 397 U.S. at 142; it is a virtual prohibition against the conduct of business within the State.

The Ashland and Commonwealth witnesses testified they could not convert their private brand gas-and-go outlets to dealer operations, and would in all likelihood be obliged to withdraw from retail operations if the Act were sustained. (A. 457, 463, 531). The State's expert witness conceded he had no reason to dispute this testimony. (A. 625, 628). Similar testimony — also uncontroverted — was offered by Kayo Oil Company and Hudson Oil Company. (A. 357-58, 519). The Ashland and Commonwealth witnesses also testified their companies would find it extremely difficult, if not impossible, to continue wholesale operations in Maryland if their retail outlets were lost, and that the most likely result would be a decision to divert gasoline to other

areas. (A. 508). The State made no effort to contradict this testimony and, indeed, further strengthened it through cross-examination. (A. 463, 511). The State offered no evidence to show that the gaps left by withdrawal of these retailers and wholesale suppliers would be filled by others.[19]

These facts belie the Maryland Court's conclusion that "there will be no significant disruption of the flow of petroleum products into the state nor in the distribution of those products to those in interstate commerce." (J.A. 24a). The uncontradicted evidence shows that the Act would create positive disincentives for certain firms to do business in the State and positive incentives for others to withdraw, and that this would impede the flow of petroleum products into the State. (A. 383). In both cases, the entrants most likely to be excluded, and the participants most likely to be forced to withdraw, would be independent refiner-marketers such as Ashland and Commonwealth that distribute lower-priced private brand gasoline. (A. 376-77).

Any regulation which so seriously and pervasively interferes with "the natural functioning of the interstate market," *Hughes v. Alexandria Scrap Corp., supra,* 426 U.S. at 806, must be found to impose a substantial burden on interstate commerce.

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[19]There is no factual basis for the Maryland Court's conclusion that "it still might be possible," if the Act were sustained, for companies that market exclusively through company-operated stations "to distribute products in Maryland both through dealer operations and on the wholesale market." (J.A. 23a). Although some of the company witnesses stated that the question of withdrawal had not yet been formally considered by their boards of directors (A. 360, 463), all of them made it clear that withdrawal was the only rational economic choice. (A. 358, 457, 508).

B. The Maryland Act Discriminates Against Interstate Commerce

This Court has consistently held that a state's power to regulate commerce cannot be used to discriminate against interstate sellers of goods or services. As Mr. Justice Brandeis said in *Baldwin v. G.A.F. Seelig, Inc., supra,* 294 U.S. at 527:

> What is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation . . . . Neither the power to tax nor the police power may be used by the State of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an unreasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin. They are thus hostile in conception as well as burdensome in result.

The same rationale underlies more recent decisions of this Court. *See, e.g., Hunt v. Washington State Apple Advertising Commission, supra; Boston Stock Exchange v. State Tax Commission, supra; Dean Milk Co. v. City of Madison, supra; H.P. Hood & Sons, v. Du Mond, supra; Nippert v. City of Richmond, supra.*

Based on the evidence presented at the trial, the trial court specifically found that

> among the experts who testified there was unanimous agreement that in precluding the independent crude-deficient refiners from selling at retail in Maryland, a powerful source of price competition with the branded dealers would be

> eliminated, the effect of which would be anti-consumer . . . . (J.A. 130a).

The trial court also found that the divestiture provisions of Paragraphs B and C of the Act "would be harmful to competition in the industry, and would primarily serve to protect the independent dealers rather than the public at large." *Id.* Its conclusion was definitive: "the entire bill is designed to benefit one class of merchants to the detriment of another." (J.A. 131a).[20]

The merchants benefited are the local dealers who operate major brand service stations. The merchants harmed are the independent refiner-marketers that supply private brand gasoline at discount prices. All of these refiners are out-of-state companies that sell at retail through company-operated outlets in direct competition with the major brand dealers.

The Maryland Court of Appeals did not disturb the trial court's specific factual findings. It simply disregarded them in the apparent belief that the discrimination issue could be resolved solely on legal grounds. The Court of Appeals said that the Act did not discriminate against interstate commerce because the legislative history showed its purpose "was to preserve competition within the retail gasoline marketing industry in Maryland. . . . not to protect Maryland interests from out-of-state competition." (J.A. 19a). It also said the Act did not "in effect discriminate against out-of-state economic interests" because

> [t]he Act is equally applicable to all producers and refiners . . . . If a refiner were to build refineries in

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[20]Despite these findings, the trial court concluded the Act did not violate the Commerce Clause, apparently on the theory that the Act was a local regulation not affecting the flow of petroleum products into the State. (J.A. 123a). The error of this view has already been exposed. See pp. 24-26, *supra.*

> Maryland, and were to engage in business solely within Maryland, it would be prohibited by the Act from marketing through a company operated station. (J.A. 19a-20a).

The Maryland Court's mechanistic approach is much at variance with this Court's practice in reviewing cases of possible discrimination against interstate commerce. This Court has made clear that a state statute will not be sustained under the Commerce Clause simply because it professes to be an even-handed exercise of the police power, for this

> would mean that the Commerce Clause of itself imposes no limitations on state action . . . save for the rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods.

Dean Milk Co. v. City of Madison, supra, 340 U.S. at 354. Nor is it dispositive that some local interests might be as heavily affected as the interstate interests. *Id.*; *see also Nippert v. City of Richmond, supra,* 327 U.S. at 431. The question, rather, is whether the state law, considered in economic context, "will in its practical operation work discrimination against interstate commerce." *Best & Co. v. Maxwell,* 311 U.S. 454, 456 (1940); *see also Hunt v. Washington State Apple Advertising Commission, supra,* 97 S.Ct. at 2445; *Great Atlantic & Pacific Tea Co. v. Cottrell, supra,* 424 U.S. at 375; *Polar Ice Cream & Creamery Co. v. Andrews,* 375 U.S. 361, 380 (1964); *Baldwin v. G.A.F. Seelig, Inc., supra,* 294 U.S. at 527.

The Court of Appeals seemed to believe there could be no discrimination against the out-of-state refiners because a hypothetical Maryland refiner would also be subject to the Act. However, the economic conflict in this case does not arise at the manufacturing level, but at the retail level. The

burdens imposed on refiners operating at the retail level have been described above.[21] The discriminatory effects of these burdens are too obvious to require extended discussion.

The Act requires all refiners to adopt a method for distributing products at retail which only some of them can, in fact, use. The practical effect of this requirement is to exclude independent refiners, such as Ashland and Commonwealth, from selling gasoline at retail through company-operated private brand outlets, and to prevent other refiners with similar operations from entering the State. This in turn affects the entire private brand sector by curtailing supply sources for wholesalers and independent marketers also operating private brand stations. The ultimate effect, as the trial court found, will be to reduce competition between the private brand and major brand sectors of the market. (J.A. 130a-131a). The beneficiaries will not be the Maryland consumers and interstate travellers who purchase gasoline at retail, but the local dealers who sell higher-priced gasoline at major brand service stations.

As recently as last term, this Court found it "somewhat suspect" that the demands of local apple growers had been mainly responsible for labeling regulations which singled out containers used for transporting apples in interstate commerce. *Hunt v. Washington State Apple Advertising Commission, supra,* 97 S.Ct. at 2446. Similar suspicions are warranted here with respect to a statute which in fact applies only to out-of-state refiners, which benefits only local service station dealers, and which perhaps "artlessly discloses" its purpose, *Dean Milk Co. v. City of Madison, supra,* 340 U.S. at 354, by providing that all service stations associated with refiners "must be operated by a retail service station dealer." These suspicions are fully confirmed when the Act's history is given a more thorough

[21] See pp. 26-27, *supra.*

examination than the Maryland Court of Appeals chose to undertake.

As previously noted, the Act had its inception during the 1973-74 gasoline shortage which followed imposition of the OPEC oil embargo. Reacting to complaints received from station operators and the general public, the Governor asked the Comptroller to determine whether the gasoline shortage was "real or contrived" and whether suppliers were making fair allocations. (A. 183, 687-88). Although audit investigations conducted by the Gasoline Tax Division of the Comptroller's Office failed to reveal any instances of unfair allocation (A. 551, 556-57, 563-64), a survey addressed to retail service station operators disclosed widespread discontent not only with supply allocations but also with such collateral matters as alleged unfair terminations of dealers, conversion of dealer-operated stations to company operations, sharp increases in wholesale prices, and withdrawal of allowances and other benefits.[22]

After reporting to the Governor, the Comptroller's Office prepared draft legislation to be introduced to the Legislature. The draft contained specific provisions requiring uniform apportionment of gasoline supplies during periods of shortage (now Paragraph F of the Act) and other provisions relating to dealer-supplier relationships (now Paragraphs D and E of the Act). It also contained provisions prohibiting producers, refiners and wholesalers from operating retail service stations. (A. 721-22). The reason for these prohibitions is obscure; the draftsman testified that he did not consult any economists or industry experts when he prepared the bills, and that none of

[22]The results of this survey were summarized in a report submitted to the Governor, and made available to the Legislature along with other materials prepared by the Gasoline Tax Division. (A. 698-704). The report, which contained rank hearsay, was admitted into evidence not for the truth of its conclusions but only because it formed part of the legislative history. (A. 547-49).

the facts developed by the surveys had any relation to the divestment provisions he inserted. (A. 563-65, 582). Indeed, he stated he knew of no reason why the legislation was necessary, and that he drafted the bills simply because the Comptroller directed him to do so. (A. 575-76).

When the bills were before the Legislature, they were vigorously supported by the Greater Washington/Maryland Service Station Association, whose representative testified that the 700 local Maryland dealers who belonged to the Association were the objects of a

> sinister threat of the major oil companies to complete their takeover of the retail-marketing of gasoline, not just to be in competition with their own branded dealers, but to squeeze them out and convert their stations to company operations. . . . An example of this is the BP move to eliminate its 8,000 dealers to replace them with a limited number of company-operated "Gas & Go" outlets which sell gasoline only with no service to the motorist. (A. 755, 756, 758).

Although the bills were opposed by major oil company representatives who also testified at the legislative hearings (A. 729-54), the Act was adopted by a lopsided majority and signed by the Governor. (A. 186-87).

The only substantive change made during the Legislature's consideration of the bills was to remove the restriction on company-operated stations by wholesalers. Why this was done is unclear. The draftsman testified he had included wholesalers along with producers and refiners so as "not to discriminate against one class as to another," and that he had later heard "some of the wholesalers being local jobbers . . . wanted to plea on the mercy of the committee so to speak and amend themselves out and let the

law apply to those that were entirely the producers and refiners." (A. 568).[23]

Although the Legislature issued no findings, it is apparent that the Act was conceived as a measure to protect dealers from assorted threats and pressures, including the threat of being replaced by "a limited number of company-operated 'Gas & Go' outlets which sell gasoline only with no service to the motorist." (A. 758). Paragraphs B and C of the draft bills addressed that problem by prohibiting company operations by *all* suppliers to retail stations, including wholesalers. The wholesalers, who were "local businessmen" (A. 569), objected and were amended out. (J.A. 131a). The only companies left subject to the prohibition were the out-of-state producers and refiners — including not only the "major oil companies" that the dealer representative had denounced, but also producers and refiners which had no dealers.

This Court has noted that certain kinds of statutes "lend themselves peculiarly" to discrimination against interstate commerce, and that

> this is often if not always the object of the local commercial influences which induce their adoption. Provincial interests and local political power are at their maximum weight in bringing about acceptance of this type of legislation. With the forces behind it, this is the very kind of barrier the commerce clause was put in the fundamental law to guard against.

Nippert v. City of Richmond, supra, 327 U.S. at 434; *see also Southern Pacific Co. v. Arizona, supra,* 325 U.S. at 767 n.2. Although the traditional vehicles of these "provincial

[23]No transcripts of the hearing were made. However, the record reflects that representatives of several wholesalers and of the Maryland Oil Jobbers Council testified before the Senate Committee. (A. 186).

interests" have been statutes directed against door-to-door salesmen and out-of-state milk producers, the potential range of discriminatory legislation supported by local political power is not so limited.

The legislation adopted in Maryland to prevent company operation of retail service stations is but one example of a recent nationwide movement at the state level to restructure distribution patterns in the petroleum industry.[24] In Maryland, as elsewhere, the independent dealers' lobbyist groups have supplied the primary impetus for the enactment of the divestiture statutes. Part of the reason for this is the dealers' desire to protect their profit margins in the face of competition from company-operated gas-and-go outlets. (A. 610-13). The potential disruption which this dealer-inspired movement represents was recently underscored by a representative of the Federal Trade Commission:

> One problem is that several states — Maryland is a prime example — have enacted so-called marketing divestiture laws which . . . preclude direct operation of outlets by the refiners. Pushed through the legislatures by the franchised dealers,

[24]Legislation of the type at issue here has been considered in many states, and has been adopted by Florida, Delaware and the District of Columbia as well as by Maryland. *See* FLA. STAT. ANN. §526.151 (Supp. 1974); DEL. CODE ANN. §§2905-06 (Cum. Supp. 1976); D.C. LAW 1-123 (Council of the District of Columbia, April 19, 1977). The Florida statute was declared unconstitutional by a state trial court in *Exxon Corp. v. Conner,* Case No. 74-1449 (Cir. Ct., 2d Jud. Cir., Leon County, January 25, 1975); that decision was not appealed. The Delaware statute was recently found constitutional by the Delaware Court of Chancery, largely on the authority of the decision here under review. *Atlantic Richfield Co. v. Tribbitt,* C.A. Nos. 4692, 4774 (Del. Ch., Newcastle County, August 25, 1977). *See also Opinion of the Justices,* ___ N.H. ___, 376 A.2d 118 (1977), in which the New Hampshire Supreme Court ruled that proposed divestiture legislation would be constitutional, again in reliance on the opinion of the Maryland Court of Appeals.

> such legislation has sometimes had the practical effect of eliminating from state markets the *non-branded* dealers. These price-competitive retail outlets have generally been directly operated by employees of independent refiners. By failing to exempt these smaller refiners, who believe they cannot operate efficiently through a franchise system, these laws are apparently eliminating the very price cutters who most benefit consumers.[28]

The Maryland Legislature, acting in a crisis atmosphere and hearing only the voices of local dealers and wholesalers, enacted legislation which plainly discriminates against the out-of-state refiners that provide significant price competition to these same local interests. This Court "has often recognized that to the extent that the burden of state regulation falls on interests outside the state, it is unlikely to be alleviated by the operation of those critical restraints normally exerted when interests within the state are affected." *Southern Pacific Co. v. Arizona, supra,* 325 U.S. at 767 n. 2. Such was the case here. The discrimination created by the Maryland Act, which interferes with the federal interest in guaranteeing "free access to every market in the Nation," *H.P. Hood & Sons v. Du Mond, supra,* 336 U.S. at 539, thus represents "the very kind of barrier the commerce clause was put in the fundamental law to guard against." *Nippert v. City of Richmond, supra,* 327 U.S. at 434.

[28]Statement of Owen M. Johnson, Jr., Director, Bureau of Competition, Federal Trade Commission, commenting on H.R. 130 and related bills, before the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources (May 25, 1977), at 8-9 (emphasis in the original).

C. The Discriminatory Burdens Imposed by the Maryland Act Cannot be Justified by Any Legitimate Local Interest.

Although the Maryland Court of Appeals denied that the Act burdened commerce, it also found that "the state's interest, as determined by the Legislature, outweighs any slight burden which the Act may impose on interstate commerce." (J.A. 24a). The state interest identified by the Maryland Court was the Legislature's desire to preserve competition by preventing control of the retail market "by a few major oil companies." (J.A. 19a).

When discrimination against interstate commerce has been demonstrated, "the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of non-discriminatory alternatives, adequate to preserve the local interests at stake." *Hunt v. Washington State Apple Advertising Commission, supra,* 97 S.Ct. at 2446; *see also Great Atlantic & Pacific Tea Co. v. Cottrell, supra,* 424 U.S. at 371-73; *Pike v. Bruce Church, Inc., supra,* 397 U.S. at 142; *Dean Milk Co. v. City of Madison, supra,* 340 U.S. at 454. This burden is especially great when the interest asserted is unrelated to the protection of health and safety, because a state's promotion of local economic interests is permissible only if there is no undue discrimination against out-of-state interests. *H.P. Hood & Sons v. Du Mond, supra,* 336 U.S. at 531-33.

The Court of Appeals made no serious effort to balance competing local and interstate interests because it erroneously concluded that the Maryland Act did not burden or discriminate against interstate commerce. Had it performed the balancing process which this Court's precedents require, the Maryland Court would have been obliged to consider whether retail stations operated by independent refiners pose a threat to competition. The trial

court found that these retail stations were "a powerful source of price competition with the branded dealers," and that their elimination from the marketplace would be "anti-consumer." (J.A.130a). The Court of Appeals itself noted the State's concession "that the Act, by excluding certain partially integrated marketers, could in some respects be anti-competitive" (J.A. 15a), but failed to give this factor any weight in its consideration of the Commerce Clause issue.

The Maryland Court's analysis of that issue reflects an assumption that the Legislature's judgment concerning the need to order divestiture of company-operated retail stations could not be questioned if the Legislature reasonably believed the measure might be necessary. (J.A. 19a, 24a). This assumption is wrong as a matter of law:

> Local regulations which would pass muster under the Due Process Clause might nonetheless fail to survive other challenges to constitutionality that bring the Supremacy Clause into play. Like any local law that conflicts with federal regulatory measures, state regulations that run afoul of the policy of free trade reflected in the Commerce Clause must also bow.

Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 529 (1970) (citations omitted); *cf. City of New Orleans v. Dukes*, 427 U.S. 297, 304 n. 5 (1976). However, even if the Maryland Court's assumptions were correct, there is no rational connection in fact between the retail activities of companies such as Ashland and Commonwealth and the supposed "evils" the court said the Legislature wished to correct.

These putative evils, as outlined by the Court of Appeals, were alleged discriminations in supply between company-operated and dealer-operated stations during the 1973-74 fuels crisis and reported plans of some companies to increase company-operated stations at the expense of dealers.

(J.A. 19a). Whatever the merits of these charges as applied to companies which market primarily through dealers,[26] the requirement that companies such as Ashland and Commonwealth must cease to operate retail service stations clearly cannot be justified as a legitimate dealer-protection measure. Ashland and Commonwealth do not operate through dealers in Maryland and have never done so. They thus have no dealers to terminate, to discriminate against as to supplies, or otherwise to treat unfairly.

The State also sought to show at the trial that divestiture was needed to inhibit vertically-integrated companies from using "immense windfall profits from the crude price increases" of recent years to "discipline" aggressive price marketers by means of selective price reductions at the retail level. (A. 594).[27] However, the expert who offered this theory admitted that crude-deficient refiners such as

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[26]The trial court found that the State had failed to produce any evidence to show that any company had discriminated against dealers in allocating supplies during the crisis period. (J.A. 131a). This finding was fully supported by the record. (A. 563-64).

[27]The theory that some refiners may be using production profits to disrupt the retail market was recently disputed by a representative of the Federal Energy Administration:

> While there are numerous allegations concerning refiners using profits from crude oil production to subsidize retail operations, we have been unable to amass substantial evidence that this is taking place on a scale that would threaten the competitive viability of branded independent dealers or any other segment of the gasoline retailing business. As pointed out earlier, branded independent dealers still sell over 71 per cent of the gasoline sold through service stations, and their market share has been essentially stable over the past year.

Statement of Gorman C. Smith, Acting Deputy Director, Federal Energy Administration, commenting on H.R. 130 and related bills, before the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources (May 25, 1977), at 9. *See also id.* at 12.

Ashland and Commonwealth do not have the capacity to engage in this practice (A. 629), and that such independent refiners were themselves victims of the crisis which produced the "immense windfall profits" to which he had referred. (A. 624-25). This same expert testified he was "troubled" by the Act's application to independent refiners (A. 590), and agreed this was a "negative" feature of the Act. (A. 630). Indeed, he admitted that if he, as a professional economist, had been called upon to draft the Act he "wouldn't have drafted the law as it is drafted now." (A. 631).

The only justification which the State could offer for forbidding companies such as Ashland and Commonwealth to operate retail stations relates not to the retail gasoline market, but to alleged long-term effects on the wholesale market if certain assumptions about the operations of independent refiners prove to be correct. The State's expert testified that, if independent refiners expanded retailing operations without at the same time expanding refining capacity, this could in time diminish the supply of gasoline available in the wholesale market for independent marketers. (A. 594, 636-39).[28] He admitted, however, that this opinion was totally dependent on the validity of his assumption that independent refiners would not expand refining capacity in proportion to the expansion of their direct retail operations. (A. 640-41). He further admitted he had no knowledge of any facts which could support his "impression" that the development he contemplated would take place (A. 641), and none appear in the record.

[28]This opinion, which represented a departure from opinions expressed in the witness' prior publications, was developed in the sixty-day interval between the date of his deposition and the date of his testimony at the trial. (A. 623, 636, 637). It was not based on any new studies, but simply represented the witness' "reflection on the scenario of consequences." (A. 623).

It is apparent that the State's effort to justify application of Paragraphs B and C to independent refiners rests on nothing more than the theoretical *post hoc* rationalization of an expert who himself was "troubled" by the result. We submit that this slender reed cannot be used to support legislation which has such drastic effects on the interstate commerce pursued in Maryland and elsewhere by independent refiners. *Cf. Bibb v. Navajo Freight Lines, Inc., supra,* 359 U.S. at 530. The only consequence of the Act, as applied to Ashland and Commonwealth, would be to eliminate an important source of price competition in the marketplace. This would not serve the ostensible state objective of promoting competition, but rather would weaken it to the consumer's detriment.

Maryland has utterly failed to meet its obligation to show that any legitimate state interest justifies the disruptive and discriminatory burdens that Paragraphs B and C of the Act impose upon independent refiner-marketers. *See Hunt v. Washington State Apple Advertising Commission, supra.* "[T]he very purpose of the Commerce Clause was to create an area of free trade among the several states." *Boston Stock Exchange v. State Tax Commission, supra,* 429 U.S. at 328. The freedom which it protects "is a freedom to trade with any State, to engage in commerce across all State boundaries." *Id.* at 335. The unjustified exclusion of independent refiners such as Ashland and Commonwealth from participating in the Maryland retail market totally subverts this fundamental constitutional principle.

CONCLUSION

The Maryland Act represents an effort by a single state legislature to deal at the local level with economic problems which are national and even international in scope, and which have their origins outside the boundaries of the state. Maryland has attacked the problem at the retail level

because this is the only aspect of the petroleum industry over which it has any control. Although Maryland has the power to legislate to protect the economic welfare of its citizens, this power cannot be used — either legally or practically — to affect the economic organization of an entire industry. Only Congress could enact uniform rules to govern marketing patterns in an industry as complex and as vital to the nation's welfare as this one is, if any such rules are needed.

Since the inception of severe energy shortages and escalating petroleum prices in 1973, the Congress has been actively considering the complex structure of the petroleum industry to determine whether federal legislation is needed to regulate its marketing practices. In the 94th Congress, the Senate passed S. 323, which would have limited the ability of major market shareholders to increase the number of their company-operated retail outlets. This bill exempted independent refiners such as Ashland and Commonwealth from the definition of "major market shareholders." Also in the 94th Congress, the House of Representatives considered H.R. 13000, which would either have declared a two-year moratorium on openings of refiner-operated retail outlets or have imposed an elaborate system of functional accounting to identify profits earned by the different branches of integrated companies.[29]

None of these proposals was enacted, due in part to the opposition of the Federal Trade Commission and the Federal Energy Administration. *See* H. R. Rep. No. 94-

[29]The current Congress is considering similar proposals. S. 323 has been reintroduced as S. 19 by Senator McIntyre, again with an exemption for independent refiners. Senator Durkin has introduced S. 743, which pursues the concept of functional pricing contained in H.R. 13000. Hearings were held on both proposals on May 25, 1977, by the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources.

1615, 94th Cong., 2d Sess. (Sept. 18, 1976). The FEA noted, for example, that

> FEA opposes a marketing moratorium which would restrict either the gasoline volume or the total number of refiner operated retail outlets. Any such moratorium would seriously interfere with competition in the marketplace and would encourage continuance of some inefficient operations . . . .
>
> Applying the lessons we have learned from over two years of price and allocation controls we find that, unfortunately, there are no easy solutions. Legislation designed to specifically prohibit unfair pricing practices often results in either restricting competition or the ability of a franchisor to expand his business to whatever extent market conditions might allow. *Id.* at 36.

It is unnecessary for this Court in this case to determine what adjustments in established petroleum marketing patterns are necessary or appropriate in the national interest. The issue presented here is far narrower. That issue is whether Maryland may restrict producers and refiners of petroleum to a single method of retail distribution within its borders when the practical effect of this restriction is to exclude an entire class of refiner-marketers from doing business in the State.

We submit that Paragraphs B and C of the Maryland Motor Fuel Inspection Law are wholly inconsistent with "the Commerce Clause's overriding requirement of a national 'common market.'" *Hunt v. Washington State Apple Advertising Commission, supra,* 97 S.Ct. at 2445. Accordingly, we ask that the judgment of the Court of

Appeals of Maryland sustaining the constitutionality of those provisions be reversed.

Respectfully submitted,

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